



**COUNTY OF LOS ANGELES  
DEPARTMENT OF AUDITOR-CONTROLLER**

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J. TYLER McCAULEY  
AUDITOR-CONTROLLER

November 29, 2001

TO: Supervisor Michael Antonovich, Mayor  
Supervisor Gloria Molina  
Supervisor Yvonne Brathwaite Burke  
Supervisor Zev Yaroslavsky  
Supervisor Don Knabe

FROM: J. Tyler McCauley  
Auditor-Controller

SUBJECT: **Department of Health Services Community Health Plan Fiscal Year  
2000-2001 Financial Audit**

Attached is a copy of the independent auditor's report and management letter for the Department of Health Services Community Health Plan (CHP) fiscal year (FY) 2000-2001 financial audit. The audit was performed by Brown Armstrong Randall Reyes Paulden & McCown, Certified Public Accountants (Brown Armstrong).

California law requires CHP and other managed care plans to submit annual financial statements, that have been audited by an independent Certified Public Accountant, to the State Department of Managed Health Care. The statements must be accompanied by an opinion on the fairness of the financial statement presentation. Brown Armstrong expressed an unqualified opinion on the CHP's financial statements for FY 2000-2001. CHP has submitted the report to the Department of Managed Health Care, as required.

**Internal Control Findings**

In prior years, independent auditors noted that CHP did not have an effective system (e.g., computer system, sufficient staff/space, etc.) to process claims accurately and timely. During FY 1999-2000, CHP implemented most of the recommended actions, but still needs to replace its current computer system to achieve full implementation of all recommendations. Brown Armstrong continues to note this as a reportable condition in the FY 2000-2001 Report on Compliance and Internal Control over Financial Reporting.

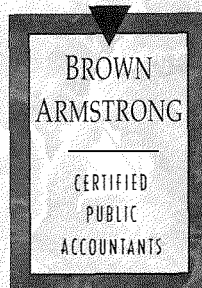
Brown Armstrong also continues to report previously identified weaknesses in the CHP's internal control structure, such as misplaced claim files, reconciliation of revenues with enrollment, deficiencies in the patient management system and the inability to handle increased growth. These issues were discussed with CHP management and are included in the auditor's "Communications with Management," which is enclosed with the Report on Compliance and Internal Control. Three of the five weaknesses will continue to be reported until such time as CHP's computer system is replaced. There were no new weaknesses identified by the auditors for FY 2000-2001.

CHP indicated that they have taken or are taking actions to correct the reportable condition and other weaknesses in the internal control structure.

If you have any questions, please contact me or DeWitt Roberts at (213) 974-0301.

JTM:JS

C:     Chief Administrative Office  
          David E. Janssen, Chief Administrative Officer  
          Public Information Officer  
          Department of Health Services  
          Fred Leaf, Acting Director  
          Gary Wells, Director of Finance  
          Dave Beck, Office of Managed Care  
          Sachai Hamai, Inspection & Audit  
          Lloyd W. Pellman, County Counsel  
          Audit Committee (6)



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**REPORT ON COMPLIANCE AND ON INTERNAL CONTROL  
OVER FINANCIAL REPORTING BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN  
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

To the Board of Supervisors of the  
County of Los Angeles, California

We have audited the financial statements of the Community Health Plan (CHP) as of and for the year ended June 30, 2001, and have issued our report thereon dated August 31, 2001. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Community Health Plan's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed an instance of noncompliance that is required to be reported under *Government Auditing Standards*, which is described in the accompanying schedule of reportable conditions.

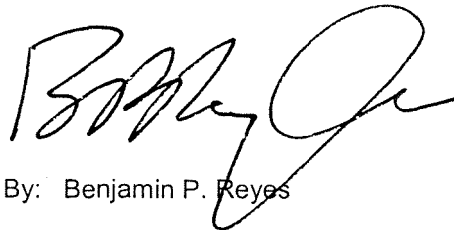
Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Community Health Plan's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. However, we noted a certain matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Community Health Plan's ability to record, process, summarize and report financial data consistent with the assertions of management in the general purpose financial statements. The reportable conditions are described in the accompanying schedule of reportable conditions.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation of the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above to be material weaknesses. We also noted other matters involving the internal control over financial reporting that we have reported to management of the Community Health Plan in a separate letter dated August 31, 2001.

This report is intended solely for the information and use of management, others within the organization, and the Board of Supervisors and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG RANDALL  
REYES PAULDEN & McCOWN  
ACCOUNTANCY CORPORATION

A handwritten signature in black ink, appearing to read 'B. Reyes', is written over the printed name.

By: Benjamin P. Reyes

Bakersfield, California  
August 31, 2001

**COMMUNITY HEALTH PLAN  
REPORTABLE CONDITIONS  
JUNE 30, 2001**

**Status of Prior Year Findings and Recommendations**

**Finding 1. Compliance - Claims Processing System**

Community Health Plan does not have an effective system to process claims accurately and in a timely manner as required by California Health and Safety Code Section 1371. As a result, CHP has to make interim payments and prepayments for certain claims so that CHP will be in compliance with the Health and Safety Code requirements. The infrastructure, personnel, internal controls and current computer systems (administrative capacity) in place at CHP are not able to keep up with the projected growth of CHP.

**Recommendation**

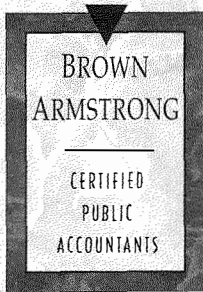
CHP needs to review its current computer system, to hire and train additional claims processors, to obtain more office space, and to improve its internal control and procedures over claims processing so that it can process claims accurately and in a timely manner.

**Management Response**

CHP management agrees that the administrative capacity in the past negatively impacted the Plan's ability to process medical service claims in a timely manner. However, this condition has been corrected. CHP obtained final Board authority to hire an additional thirteen permanent, full-time claims processing-related positions in September 1999 and has filled the new positions. CHP is developing a comprehensive claims processing policy and procedures manual which will be issued to claims processing staff. Claims processing internal controls will also be strengthened. Additional office and storage space has also been obtained in fiscal year 2000.

**Current Year Status**

The recommendation has been implemented except that CHP is still waiting for approval to proceed with the acquisition of a new computer system from the Los Angeles County Department of Health Services.



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**COMMUNICATION WITH MANAGEMENT**

To the Board of Supervisors of the  
County of Los Angeles, California

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Chris M. Thornburgh, CPA  
Joan M. Anderson, CPA  
Bradley M. Hankins, CPA  
B. Marie Ebersbacher, CPA, CFE  
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We have audited the financial statements of Community Health Plan for the year ended June 30, 2001 and have issued our report thereon dated August 31, 2001. In planning and performing our audit of the financial statements of Community Health Plan we considered its internal control structure in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control structure. We also considered compliance with laws and regulations in accordance with Government Audit Standards issued by the GAO.

During our audit, we noted agreed-upon conditions involving the internal control structure. These comments and recommendations, all of which have been discussed with the appropriate members of management, were intended to improve the internal control structure or result in other efficiencies and are described in the attached findings and recommendations.

This letter is intended solely for the information and use of management, others within the organization, the Board of Supervisors and is not intended to be and should not be used by anyone other than these specified parties.

BROWN ARMSTRONG RANDALL  
REYES PAULDEN & McCOWN  
ACCOUNTANCY CORPORATION

By: Benjamin P. Reyes

Bakersfield, California  
August 31, 2001

**COMMUNITY HEALTH PLAN  
AGREED-UPON CONDITIONS  
JUNE 30, 2001**

**Status of Prior Year Findings and Recommendations**

**Finding 1. Misplaced Claim Files**

CHP was not able to locate two claims file out of our twenty-five claims disbursement testing samples so that we were not able to perform our testing. Further discussion with management indicates that CHP has had inadequate space and manpower to handle its increased volume of claims before moving to its new facility in the current year.

Recommendation

CHP should develop an organization system to maintain claim files and other original accounting records under current situation.

Management Response

CHP agrees with the recommendation and has revised its organization system to better maintain claim files. Staff now file claims on the date completed. These claims are now archived as they are completed, and the retrieval process is as simple as querying the Patient Management System for the date completed, and then locating the file in the proper storage container. The revampment of the filing system should minimize much of the manual sorting and re-sorting of claims.

Current Year Status

CHP has devoted more attention and effort to its file organization problem after November 1999, and the problem appears to be improved. However, similar conditions were noted in current year.

**Finding 2. Unskilled Claims Processor**

During our claims disbursement testing, we noted one instance of procedure code modifier claim mistakenly paid at the regular rate instead of at the Medi-Cal rental rate. Further discussion with management indicates that certain claims processors are unfamiliar with modifiers.

Recommendation

CHP should train and cross-train all claims processors to be aware of procedure code modifiers. In addition, double check by other processors and review by supervisors should be enforced.

Management Response

As stated in "Reportable Conditions - Finding 1", once CHP has completed its revised procedures for claims processing and its policies for internal control, it will be in a position to better train and cross-train all claims processors and more effectively review their work product.

Current Year Status

The recommendation has been implemented and no similar conditions were noted in the current year.

**COMMUNITY HEALTH PLAN  
AGREED-UPON CONDITIONS  
JUNE 30, 2001**

**Status of Prior Year Findings and Recommendations**

**Finding 3. IBNR Calculation**

The calculation of incurred but not reported (IBNR) claims is performed utilizing a claims received lag study. The methodology works well assuming consistency in factors such as the plan's financial responsibility, the claim amounts, demographics of its members, and the turnaround period between the date of service, the claim submittal date, and the payment date. Changes in the factors without the necessary adjustments in the calculation could lead to inaccurate amounts reported for medical expenses and IBNR reserve balance. Inaccurate IBNR calculations could significantly jeopardize CHP's ability to gauge its financial health and results of operations.

**Recommendation**

The auditor recommends that CHP perform studies to evaluate aberrations and changes in claims and the flow of claims, and factor such considerations in the calculation of IBNR. The auditor also recommends that CHP have its IBNR reviewed by a qualified actuary on a periodic basis and at the end of its fiscal year.

**Response**

CHP agrees with the recommendation. The Office of Managed Care previously retained a consulting firm to assist in a study of capitation rates and actuarial analysis, and recently had follow-up discussions on a proposed project for additional assistance in IBNR methodologies for medical and pharmacy costs.

**Current Year Status**

No actuarial study has been performed over CHP's IBNR.

**Finding 4. Reconciliation of Capitation Revenues with Member Enrollment**

The manual reconciliation of member eligibility and monthly capitation produces variances each month that are recorded as a liability at the end of the fiscal year.

**Recommendation**

CHP needs to fully automate the process of the member eligibility reconciliation, retroactive enrollment and disenrollments, and capitation receipt and distribution to ensure that all members and capitation is properly accounted for.

**Response**

CHP agrees with the recommendation. The Office of Managed Care is currently evaluating another managed care information computer system to automate the above functions.

**Current Year Status**

The recommendation has not been implemented, as this organization has not acquired a replacement for its existing managed care information system.



**COMMUNITY HEALTH PLAN  
AGREED-UPON CONDITIONS  
JUNE 30, 2001**

**Status of Prior Year Findings and Recommendations**

**Finding 5. Deficiencies in the Patient Management System**

CHP needs to use a fully integrated General Ledger to interface with the Patient Management System (PMS). The current General Ledger system requires the manual input of claims data based on PMS information. The manual input of claims data is time consuming and can result in data entry errors.

**Recommendation**

CHP should use the PMS general module or another fully integrated software program that meets its needs. Such a system will reduce the risk of human data entry errors, provide a better audit trail for transactions, and allow for better analysis of accounts.

**Response**

CHP agrees with the recommendation and are currently evaluating integrated software general ledger packages to interface with the new system.

**Current Year Status**

The recommendation has not been implemented, as this organization has not acquired a replacement for its existing managed care information system.

**Finding 6. Ability to Handle Increased Growth**

The infrastructure, personnel, internal controls and current computer systems (administrative capacity) in place at the CHP may not be able to keep up with the projected growth of CHP. Many of the processes of CHP are manually intensive, e.g. calculation of capitation and IBNR. The internal checks and balances necessary for a strong internal control environment are inadequate due to limited staffing arrangements.

**Recommendation**

CHP needs to automate its manual intensive processes as quickly as possible in order to remain competitive in the managed care market and handle the projected growth of the plan

**Response**

CHP agrees with the recommendation. As stated above, the Office of Managed Care is evaluating a new managed care information system to replace the system currently in use. This new system should eliminate the manual processes identified in this recommendation.

**Current Year Status**

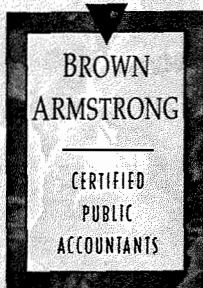
The recommendation has not been implemented, as this organization has not acquired a replacement for its existing managed care information system.

**COMMUNITY HEALTH PLAN**  
**FINANCIAL STATEMENTS**  
**WITH**  
**INDEPENDENT AUDITOR'S REPORT**  
**FOR THE YEARS ENDED JUNE 30, 2001 AND 2000**

**COMMUNITY HEALTH PLAN  
JUNE 30, 2001 AND 2000**

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**INDEPENDENT AUDITOR'S REPORT**

To the Board of Supervisors of  
the County of Los Angeles

We have audited the accompanying balance sheets of Community Health Plan as of June 30, 2001 and 2000, and the related statements of income and changes in fund balance, and cash flows for the years then ended. These financial statements are the responsibility of Community Health Plan's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only Community Health Plan, a division of the County of Los Angeles Department of Health Services (DHS), and are not intended to present fairly the financial position of the County of Los Angeles, California, and the results of its operations and cash flows of its proprietary fund types and nonexpendable trust funds in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Community Health Plan as of June 30, 2001 and 2000, and the results of its operations, changes in its fund balance, and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

BROWN ARMSTRONG RANDALL  
REYES PAULDEN & McCOWN  
ACCOUNTANCY CORPORATION

Bakersfield, California  
August 31, 2001

**COMMUNITY HEALTH PLAN  
BALANCE SHEETS  
JUNE 30, 2001 AND 2000**

	<u>2001</u>	<u>2000</u>
<b>ASSETS</b>		
Current Assets		
Pooled cash and investments	\$ 41,651,878	\$ 35,649,465
Accounts receivable	7,713,005	12,751,613
Interest receivable	659,321	745,452
Due from other L.A. County funds	466,150	296,557
Capitation premium receivable	<u>11,262,964</u>	<u>936,912</u>
Total Current Assets	<u>61,753,318</u>	<u>50,379,999</u>
Other Assets		
Restricted investments	<u>304,773</u>	<u>305,557</u>
<b>TOTAL ASSETS</b>	<u><b>\$ 62,058,091</b></u>	<u><b>\$ 50,685,556</b></u>
 <b>LIABILITIES AND FUND BALANCES</b>		
Current Liabilities		
Accounts payable and other accrued liabilities	\$ 2,327,387	\$ 1,870,090
Estimated medical claims payable	6,664,835	5,127,680
Accrued health care expenses	22,580,282	21,735,505
Due to other L.A. County funds	<u>25,439,297</u>	<u>4,930,660</u>
Total Current Liabilities	57,011,801	33,663,935
Fund Balance	<u>5,046,290</u>	<u>17,021,621</u>
<b>TOTAL LIABILITIES AND FUND BALANCES</b>	<u><b>\$ 62,058,091</b></u>	<u><b>\$ 50,685,556</b></u>

The accompanying notes are an integral part of these financial statements.

**COMMUNITY HEALTH PLAN  
STATEMENTS OF INCOME  
AND CHANGES IN FUND BALANCE  
FOR THE YEARS ENDED JUNE 30, 2001 AND 2000**

	<u>2001</u>	<u>2000</u>
Premiums	\$ 126,227,427	\$ 102,233,262
Cost of Medical Care Provided	<u>115,491,524</u>	<u>91,592,136</u>
	<u>10,735,903</u>	<u>10,641,126</u>
General and Administrative Expenses		
Salaries and employee benefits	6,006,077	4,745,527
Service and supplies	5,121,840	4,072,512
Amortization	-	277,772
Repair and maintenance	102,080	100,758
Marketing	132,114	132,028
Rental	<u>858,535</u>	<u>-</u>
Total General and Administrative Expenses	<u>12,220,646</u>	<u>9,328,597</u>
Operating Income (Loss)	(1,484,743)	1,312,529
Non-Operating Income		
Interest income	<u>2,509,412</u>	<u>2,198,059</u>
Net Income	1,024,669	3,510,588
Fund Balance, beginning of year	17,021,621	13,511,033
Equity Transfer to L.A. County Department of Health Services	<u>(13,000,000)</u>	<u>-</u>
Fund Balance, end of year	<u>\$ 5,046,290</u>	<u>\$ 17,021,621</u>

The accompanying notes are an integral part of these financial statements.

**COMMUNITY HEALTH PLAN  
STATEMENTS OF CASH FLOWS  
FOR THE YEARS ENDED JUNE 30, 2001 AND 2000**

	<u>2001</u>	<u>2000</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Operating income (loss)	\$ (1,484,743)	\$ 1,312,529
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Amortization	-	277,772
Changes in operating assets and liabilities:		
Decrease (increase) in interest receivable	86,131	(200,047)
Decrease (increase) in reinsurance recoveries receivable	-	1,157,624
Decrease (increase) in accounts receivable	5,038,608	(3,205,913)
Decrease (increase) in due from other L.A. County funds	(169,593)	(58,049)
Decrease (increase) in capitation premium receivable	(10,326,052)	(638,861)
Decrease (increase) in prepaid medical claims expenses	-	3,671,601
Decrease (increase) in restricted investments	784	(2,390)
Increase (decrease) in accounts payable and other accrued liability	457,297	512,633
Increase (decrease) in accrued health care expenses	844,777	8,628,022
Increase (decrease) in estimated medical claims payable	1,537,155	(2,988,232)
Increase (decrease) in due to other L.A. County funds	<u>20,508,637</u>	<u>(1,209,220)</u>
Net Cash Provided by Operating Activities	<u>16,493,001</u>	<u>7,257,469</u>
<b>CASH FLOWS PROVIDED BY INVESTING ACTIVITIES</b>		
Interest income	<u>2,509,412</u>	<u>2,198,059</u>
<b>CASH USED FOR FINANCING ACTIVITIES</b>		
Equity transfer to L.A. County Department of Health Services	<u>(13,000,000)</u>	<u>-</u>
Net Increase in Cash	6,002,413	9,455,528
Cash Balance, beginning of year	<u>35,649,465</u>	<u>26,193,937</u>
Cash Balance, end of year	<u>\$ 41,651,878</u>	<u>\$ 35,649,465</u>

The accompanying notes are an integral part of these financial statements.

**COMMUNITY HEALTH PLAN  
NOTES TO FINANCIAL STATEMENTS  
JUNE 30, 2001 AND 2000**

**NOTE 1 - ORGANIZATION**

Community Health Plan (CHP) is the Medi-Cal health maintenance organization (HMO) of the County of Los Angeles Department of Health Services (DHS). It is a federally qualified HMO and is licensed as a prepaid full service health care service plan by the State of California Department of Managed Health Care under the Knox-Keene Health Care Service Plan Act of 1975.

CHP arranges for the provision of health care for Medi-Cal beneficiaries under service agreements with the State of California Department of Health Services (State) prior to May 1, 1997 and with Local Initiative Health Authority (L.A. Care) beginning May 1, 1997. L.A. Care is part of the State's two-plan model to provide specified Medi-Cal benefits to certain categories of Medi-Cal recipients within managed care plans. On February 11, 1997, CHP entered into a service agreement with L.A. Care as a subcontractor to arrange for the provision of health care services for L.A. Care enrollees.

CHP also participates in the Healthy Families Program (HFP) under service agreements with the State since its inception. HFP began in July 1998 and was designated to provide health care coverage for children in families with incomes too high for Medi-Cal but below 200 percent of the Federal Poverty Level (FPL). Subsequently, the Program has expanded the upper income limit to 250 percent FPL to cover additional children.

**NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Proprietary Fund Accounting** - CHP utilizes the proprietary fund method of accounting whereby revenue and expenses are recognized on the accrual basis. Substantially all revenues and expenses are subject to accrual.

**Accounting Standards** - Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, CHP has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989.

**Concentration of Source of Revenues** - CHP received approximately 99.9% of its premium revenues under its service agreements with L.A. Care and the State for the fiscal years ended June 30, 2001 and 2000.

**Pooled Cash and Investments** - CHP participates in the County pooled investment fund. Funds on deposit are pooled with other departments and managed by the County Treasurer. Because funds are highly liquid and readily available for use by CHP, they are classified as pooled cash and investments in the accompanying balance sheets. Interest earned on pooled investments is allocated to CHP's account based upon the account's average daily balance. The average annual interest rate earned on CHP's deposits during the years ended June 30, 2001 and 2000 were approximately 5.8% and 6.2%, respectively. At June 30, 2001 and 2000, substantially all investments in the County investment pool were U.S. government securities, bankers' acceptances and negotiable certificates of deposit.

**Restricted Investments** - Restricted investments consist of marketable securities which are recorded at amortized cost.



## **NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES** (Continued)

**Premiums and Medical Care Expenses** - CHP's premium revenues are primarily capitation payments received for plan enrollees on a per member per month basis. Premiums are recognized as revenue in the month in which the members are entitled to service.

CHP contracts with various County and private hospitals and clinics to provide health care services to its members. The cost of medical care includes capitation payments to contracted hospitals and clinics (in-plan health care providers), provisions for claims from other hospitals and clinics for out-of-area services (out-of-area out-of-plan health care providers), provisions for tertiary care and pharmaceutical supplies, as well as an estimate of out-of-plan services which have been incurred but not yet reported. Cost of capitation payments are recognized in the period enrollees are eligible for service. Provisions for out-of-area out-of-plan claims, tertiary care and pharmaceutical supplies are based on a percentage of premium revenue. The appropriate medical care expenditure accounts and the health care risk pool liability account are increased in the period the capitation payments are recognized. As claims for out-of-area out-of-plan medical services, tertiary care and pharmaceutical supplies are received and the payable amounts determined, the payable amounts are reclassified from the health care risk pool account to accounts payable. If actual claims exceed the liability for the provisions, the appropriate medical care expense accounts are then charged. The estimate of out-of-plan services which have been incurred but not yet reported is based on historical studies of claims received.

**Claims Processed on Behalf of Healthcare Providers** - CHP processes claims on behalf of various healthcare providers who are paid by CHP on a capitated basis. CHP records a liability for all claims processed, including claims that are the responsibility of the providers. For such claims, CHP records a receivable from the various healthcare providers. Claims liability for medical services provided to enrollees/eligible members are accrued in the month services are rendered. Accrued claims payable of approximately \$6,664,835 and \$5,127,680 at June 30, 2001 and 2000, respectively, represents medical service claims received but not paid as well as an accrual for claims incurred but not reported which is calculated using the methodology defined in Section 1300.77.2 of the California Code of Regulations based on historical claims experience. Management believes that accrual for claims incurred but not reported is adequate but not excessive. However, such liability is, by necessity, based upon estimates and there can be no assurance that the ultimate liability will not be more or less than the estimated amounts.

**Income Tax** - As an operating division of the County, CHP is exempt from State and Federal income taxes.

**Use of Estimates** - The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

## **NOTE 3 – RESTRICTED INVESTMENTS**

In April 1997, the Board of Supervisors of the County of Los Angeles authorized CHP to purchase obligations of the U.S. Treasury in the amount of \$300,000 to comply with the security deposit requirements of Section 1300.76.1 of Title 10, California Code of Regulations. These investments are held by the County Treasurer in CHP's name and are assigned to the Commissioner of Corporations of the State of California. At June 30, 2001 and 2000, the carrying amounts of the U.S. treasury bills were \$304,773 and \$305,557, respectively, which approximates market value. New U.S. treasury bills of a minimum value of \$300,000 will be purchased for deposit and assigned as the existing securities mature.

**NOTE 4 – ESTIMATED MEDICAL CLAIMS PAYABLE**

Medical claims payable comprise of claims payable or pending approval, and a liability for claims incurred but not yet received. As of June 30, medical claims payable consisted of the following:

	<u>2001</u>	<u>2000</u>
Claims payable/pending approval	\$ 3,826,507	\$ 2,699,344
Claims incurred but not received (IBNR)	<u>2,838,328</u>	<u>2,428,336</u>
	<u>\$ 6,664,835</u>	<u>\$ 5,127,680</u>

**NOTE 5 – ACCRUED HEALTHCARE EXPENSES**

CHP has entered into service agreements with certain County and non-County hospitals and clinics to provide primary care, ancillary services and daily hospital services to enrollees. The accompanying Statements of Income and Changes in Fund Balance include the above-mentioned medical care costs, as well as, pharmacy, out of plan, tertiary care, and excess risk costs and totaled \$115,491,524 and \$91,592,136 for the fiscal years ended June 30, 2001 and 2000, respectively.

Accrued healthcare expenses comprised of the following as of June 30,:

	<u>2001</u>	<u>2000</u>
Accrued capitated expense	\$ 5,766,490	\$ 5,666,100
Undistributed capitation*	11,231,363	11,231,363
Accrued excess healthcare expenses	<u>5,582,429</u>	<u>4,838,042</u>
	<u>\$ 22,580,282</u>	<u>\$ 21,735,505</u>

\*Undistributed capitation of \$11,231,363 for fiscal years ended June 30, 2001 and 2000, represents retroactive capitation rate adjustment amounts received by CHP but not having been distributed to capitated medical care service providers. CHP is waiting for the result of an actuarial study and approval from L.A. County Department of Health Services to determine the actual amount of the distribution.

**NOTE 6 – AMOUNTS DUE FROM (TO) OTHER L.A. COUNTY FUNDS**

CHP paid for general relief out-of-plan claims with service dates prior to October 1, 1995 and the related general and administrative costs. CHP also pays certain in-plan claims on behalf of a County health facility. These expenses are reimbursed by the County. Certain costs paid by the County on CHP's behalf are reimbursed by CHP. The amounts due from and (due to) other L.A. County funds were \$466,150 and \$(25,439,297), respectively, as of June 30, 2001 and \$296,557 and \$(4,930,660), respectively, as of June 30, 2000.

**NOTE 7 – RETIREMENT PLAN**

The County's retirement plan covers CHP employees and provides for monthly pension payments to eligible employees upon retirement. Salaries and employee benefits expense includes a provision for the retirement plan cost, as well as vacation and sick pay, which is estimated based on a percentage of salaries expense. The actual cost of the retirement plan, actuarial present value of accumulated retirement plan benefits, and net assets available for retirement plan benefits are not separately identifiable for CHP.

## **NOTE 8 – COMMITMENTS AND CONTINGENCIES**

### **Risk Management**

The County has agreed to fund CHP losses, if any, and to cover CHP under its self-insured medical malpractice program when medical services are provided at a County facility. In addition, the County has agreed to cover CHP under its self-insured worker's compensation program. These coverages are provided to CHP at no cost.

### **Non-Compliance with Health and Safety Code**

On May 14, 1999, the State Department of Corporations ("SDOC") found, among other things, that the Plan had arrearages of \$8,464,049 on provider claims and did not accrue or pay interest on any unpaid claims. On July 8, 1999, SDOC, following its on-site reviews of the Plan's operations, determined that the Plan was still delinquent in adjudicating and settling many of the claims examined on the prior audit. On September 9, 1999, SDOC issued two separate cease and desist orders arising out of the above audit and on-site reviews. Each order directs compliance with statutory or regulatory rules, as construed by SDOC, within ten (10) business days of the date of the order or be subject to administrative penalties of \$2,500 per day, beginning the eleventh business day. In October 1999, SDOC performed another on-site review. At the same time CHP has taken necessary correctional actions in response to the SDOC's orders and recommendations. In January 2000, SDOC performed another non-routine examination and determined that CHP was in compliance with state regulations and the requirements of the Knox-Keene Health Care Service Plan Act of 1975 regarding its claims processing. As a result, CHP was released from the two cease and desist orders and SDOC considered the enforcement action under the orders closed.

### **Claim Processed on Behalf of Healthcare Providers**

As discussed in Note 2, CHP processes claims on behalf of certain capitated healthcare providers. In addition, CHP prepays claims in order to meet certain California health and safety codes regarding timeliness of claim processing. CHP records these claims processed as accounts receivable and prepaid medical claims, and expects reimbursement from these healthcare providers for their portion of liability. Accounts receivables and prepaid medical claims amounted to \$7,713,005 and \$12,751,613 at June 30, 2001 and 2000, respectively. Management believes that the uncollectible amount, if any, will not be material to its financial position.

### **Contingencies**

CHP is involved in various legal actions arising in the normal course of business. These legal actions involve disputes related to reimbursement of contractual capitation amount as well as aspects of subscriber enrollment and assignment. Management believes that losses resulting from these matters, if any, have been adequately provided for in these financial statements as part of Accrued Health Care Expenses (see Note 5).

**NOTE 9 - OPERATING LEASE**

In January 2000, L.A. County entered into a ten-year lease agreement with Campus 1000, Freement Company, for 173,483 square feet of rental office space, 8,240 square feet of storage space and parking for 694 vehicles at 1000 South Freement Avenue, Alhambra, California, for the Department of Public Works, Department of Health Services and the Sheriff at an initial rental rate of \$3,245,148.

The prorated monthly rental expense for Community Health Plan is approximately \$79,200 and will be increased by 3.5% annually. The amount reported as lease expense was \$858,535 as of June 30, 2001. Future minimum lease payments are estimated as follows as of June 30, 2001.

Year Ending <u>June 30,</u>	
2002	\$ 958,418
2003	991,668
2004	1,026,082
2005	1,061,700
2006	1,098,565
Thereafter	<u>3,530,014</u>
Total	<u>\$ 8,666,447</u>

**NOTE 10 - EQUITY TRANSFER/DISTRIBUTION**

On December 14, 2000, Community Health Plan transferred \$13 million of its equity/excess reserves in the form of a cash distribution to the L.A. County Department of Health Services (DHS) to help fund the DHS Austerity Program. The Department of Health Services plans to use CHP funds to help achieve the Austerity Program Savings. Based on opinions of L.A. County legal counsel, there are no legal restrictions related to how the excess reserves of a health plan are used as long as the health plan maintains a minimum amount of excess reserves or tangible net equity required by Section 1300.76 of the California Code of Regulations.